Farm businesses

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FARM BUSINESSES: THE IMPACT OF HIGH INTEREST RATES

Leonard A. Christie
Science and Technology Division

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FARM BUSINESSES: THE IMPACT OF HIGH INTEREST RATES

ISSUE DEFINITION

During recent years, high interest rates on farm credit have greatly affected the profitability and even the viability of farm enterprises. At a time when many farms have suffered diminished cash-flow due to the divergence of their costs and commodity prices and reduction in equity based on land value, interest payments on outstanding debt have been a significant factor in increased farm bankruptcies, foreclosures and forced sales.

The problems and hardship caused by high interest rates moved farm organizations and Members of Parliament to appeal for programs to help farmers in financial distress. Federal and provincial governments were constrained to implement programs of limited assistance and to reappraise the farm credit system.

Three main issues arise from this situation. The most immediate issues are the form, extent and duration of assistance given to farmers to offset the cost of credit and legislation to allow an insolvent farmer to have an orderly liquidation of assets or time to make a proposal for financial reorganization or adjustment of debts. In the longer term, farm credit institutions could become more responsive to the needs and circumstances of farmers, particularly in providing sufficient credit at an affordable cost.

BACKGROUND AND ANALYSIS

A. Evolution of the Farm Cash-Flow Interest-Payment Problem

In 1978, few farmers, businessmen and analysts expected that, by late 1981, interest rates would reach nearly 23% per annum for low-risk commercial loans. The volatility of interest rates in 1980 reinforced their assumptions that inflation could somehow be accommodated and that high interest rates would be politically untenable. Although the costs of farm inputs were increasing, farm cash receipts rose strongly during 1980 and 1981. Furthermore, a decade of land price inflation had greatly increased the equity of many farmers. Consequently, with confidence about future income, many farmers took on more debt as the banks readily increased farm lending.

The development of this problem is shown by several indicators in Table 1. By the spring of 1981 the income-credit squeeze became evident to many farmers as farm input costs soared. In that year, total operating expenses rose over 19% higher than in 1980 and interest payments claimed over 19% of total operating expenses. During much of 1981, interest rates rose sharply and many farmers with floating interest rate loans or who were arranging mortgage renewal faced potentially crippling debt charge payments. Interest payments are still a major expenditure in most provinces, particularly in Saskatchewan and Alberta where they comprise 15% of provincial total operating expenses. Among the one-third of Canada's farmers who are the most productive yet carry most of the farm debt, interest payments represent a much larger percentage of their total expenditures. In 1990, interest payments of all farmers, after rebates, increased by about 1.5% over 1989 or by $30.1 million. Those payments claimed an increasing share of farm net cash income* during the past four years, equivalent to 27.2% in 1990.

Interest rates moderated during 1982 and eventually stabilized at 11.0% until the first quarter of 1984. Thereafter, in response to rising rates in the United States and from the Bank of Canada,

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* Net cash income = total cash receipts less operating expenses (excluding interest payments and depreciation.

TABLE 1: AGRICULTURAL ECONOMIC INDICATORS[1]

Item	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Q4 1990	Q1 1991	Q2 1991
Bank Prime Rate	12.90	14.25	19.29	15.81	11.17	12.06	10.58	10.52	9.52	10.83	13.33	14.06	13.25	11.58	10.08
5-year Mortgage Rate	11.98	14.32	18.15	17.89	13.29	13.58	12.13	11.21	11.15	11.65	12.06	13.35	12.83	11.67	11.25
FCC Long-Term Loan Rate	10.75	13.00	14.00	16.50	13.08[1]	14.4[1]	13.00[3]	11.44[4]	11.53	12.47	12.36	13.31	13.19	12.34	11.78
Consumer Price Index (annual rate)	9.2	10.2	12.5	10.8	5.8	4.4	4.0	4.1	4.0	4.1	5.0	4.8	4.9	6.4	6.3
Farm Input Price Index (annual rate)	16.8	9.7	14.3	3.2	1.1	2.6	0	1.8	1.6	2.8	2.9	1.5	2.3	2.9	-
Index of Farm Prices of Agr. Products (annual rate)	16.0	8.2	7.9	-1.9	-0.5	5.4	-5.5	-3.9	-1.2	6.1	5.7	-3.3	-5.5	-6.1	-7.9[7]
Farm Interest Payments as % of Total Operating Expenses--Canada[5]	14.4	15.3	19.2	17.5	14.5	14.4	13.5	13.6	13.3	13.3	13.2	13.2	-	-	-
Index of Farm Real Estate Value per Acre (1981=100)	70.6	88.9	100.0	99.8	95.3	90.7	84.1	77.7	71.7	70.9	74.4	77.3	-	-	-
Steers, A1,2-1000 lbs+, Toronto, $ per cwt.	80.23	80.74	80.00	80.54	78.98	85.30	81.60	83.05	88.89	87.35	88.73	89.06	91.59	90.56	89.90
Hogs, Index 100, Ontario, $ per cwt.	64.15	59.08	70.01	83.32	70.75	72.65	68.50	81.57	79.61	63.05	62.90	73.37	71.52	69.85	72.42
Corn, No. 2 CE, Chatham, & Ont., $ per tonne (crop year ending)	107.68	118.92	151.95	114.68	116.54	160.03	138.68	114.72	87.21	93.05	140.24	117.97	98.25	101.84	102.42[7]
Wheat, 1 CWRS-CWB Export, Thunder Bay, $ per tonne (crop year ending)	177.32	215.38	246.62	214.31	204.64	215.21	235.33[6]	249.12	180.72	191.12	247.27	213.19	149.38	154.85	156.22
Exchange Rate US $ per Can. $	0.8536	0.8554	0.8340	0.8103	0.8114	0.7723	0.7325	0.7197	0.7541	0.8124	0.8445	0.8570	0.8614	0.8652	0.8705

(1) Annual or period average except as noted. (2) April 1st, until 1982. (3) Annual average for 20-year loan rate. (4) Average for 15-year rate since 1986. (5) Total interest payments before rebates. (6) Lower St. Lawrence since 1985. On 18 March 1985, differential between Thunder Bay and St. Lawrence ports was $24.83 per tonne. (7) **April-May average.**

Sources: *Bank of Canada Review*; Statistics Canada; Agriculture Canada.

interest rates escalated on two occasions: to 13.5% in July 1984 and to 13.0% in mid-February 1986. By March 1987, the prime rate had receded to 8.75%, which was the lowest level since March 1978. After April 1987, the prime rate steadily advanced to 10.50% by 8 October 1987. However, immediately after the stock market crisis on 19 October 1987, the Bank of Canada increased cash reserves in financial institutions and lowered the bank rate; the prime rate went down to 9.75%. On 8 December 1988, the prime rate increased to 12.25%, and then to 13.50% from 22 March 1989 to mid-February 1990. By 20 April 1990, the prime rate reached 14.75% and remained at that level until mid-August. Thereafter, the prime lending rate steadily decreased to 12.75% by the end of December 1990 and to 9.75% by 9 May 1991. That is the lowest rate since the first quarter of 1988.

During 1990, the U.S. prime rate remained steady at 10.00% until December, when it decreased to 9.50%. At 9 May 1991, that rate is 8.50%.

On 6 April 1987, Farm Credit Act interest rates reached their lowest level since October 1979; the rate on a loan for 15 years or more was 11%. However, the rates have changed since that date as indicated in Table 1. **Since 2 August 1991, 5, 10 and 15-year fixed term loans are 11.875%, 12.25% and 12.25% respectively. Farm syndicate loans are 11.875%. Shared risk mortgages are now 11.5%. These rates are higher than in the last quarter.**

Realized net farm income for Canada in 1990 was 28.1% below the 1989 level. **Six provinces had lower realized net income than in 1989, ranging from -0.8% to -70.8%. These provinces in ascending order of loss are as follows: Nova Scotia, Prince Edward Island, Ontario, Alberta and Manitoba, Saskatchewan.** Realized net income represents the amount left for family living, from total cash receipts after operating expenses and depreciation; it includes the value of farm produce consumed by the family.

In 1991, according to Agriculture Canada's mid-year forecast, realized net income of all Canadian farms is projected to be $3.20 billion or 7.7% higher than in 1990. The two provinces expected to suffer reductions in net income are Prince Edward Island and New Brunswick. This projection includes payments that farmers will receive

through the gross revenue insurance programs (GRIP), the Net Income Stabilization Account (NISA), the Potato Growers Compensation Program and other existing programs. Nevertheless, when realized net income is adjusted by the Consumer Price Index for inflation, the 1990 and 1991 levels in the Prairie Provinces are the lowest experienced during the past decade. In Ontario, realized net income in 1990 and 1991 decreased severely for the third time since 1982. These inflation-adjusted trends are shown in Figure 1, in constant 1991 dollars.

It should be noted that the projected increase in realized net income in 1991 measured in current dollars, is due to higher program payments. Market receipts, without program payments, are projected to be 5.0% lower for the entire country than in 1990. Market receipts may be lower in every province except Newfoundland, Nova Scotia and British Columbia. The three provinces likely to suffer reductions in market receipts of 20% or more are Prince Edward Island, New Brunswick and Saskatchewan. As a result of the US-EEC trade war, grain producers in the Prairie Provinces will experience the lowest initial prices on record in inflation-adjusted terms. The initial payment in 1991-92 for No. 1 Canada Western Red Spring wheat is $95.00 per tonne, which is almost 30% lower than last year's initial payment.

B. Immediate Impacts

1. Bankruptcies

The rate of farm bankruptcies is one of the prominent impacts attributable in part to high interest rates. Bankruptcies from 1979 to 1988 are classified by farm type in Table 2. In perspective, the number of farm bankruptcies per year has been small relative to the total number of business bankruptcies and to the total number of farms. As a percentage of all business bankruptcies, farm bankruptcies were 2.2% in 1979, 3.9% in 1989 and 0.8% in 1990. The number of farms going bankrupt is about one-tenth of 1% of the total number of farms in Canada or about one-half of 1% of farms with $50,000 or more of gross sales. The farm bankruptcy figures should be interpreted carefully because they are only one aspect of farm financial problems.

From 1989 to 1990, bankruptcies increased by 21.9% to 407, the highest number since 1986. Over the ten-year period in which these statistics have been collected, the livestock and field crop sectors have suffered the greatest losses, as shown in Table 2. While bankruptcies among livestock producers have decreased, failures in field crop enterprises have continued at a higher level since 1986. The mixed livestock and field crop enterprises were the third most affected group. **From January 1979 to 30 June 1991, 4,695 farm businesses terminated in bankruptcy.**

During 1990, bankruptcies among field crop farms were concentrated in Saskatchewan (74.7%). Livestock enterprise failures were mainly in Quebec (37.6%) Saskatchewan (23.8%) and Alberta (11.9%). **The number of bankruptcies in the first two quarters of 1991 (Table 3) are approaching the highest quarterly levels of 1984 when the interest coverage ratio shown in Figure 2 had gone through a period of substantial reduction.**

2. Other Indicators of Farm Business Problems Attributable to High Interest Rates

Quantifying the true depth and extent of economic problems among farm businesses is difficult. Farm bankruptcy statistics indicate only part of the story since they do not fully account for the number of farm business failures which have occurred. We do not know the full extent of foreclosures, power-of-sale actions, and private sales. The University of Manitoba determined that for every farmer declaring bankruptcy in the province in 1985, about four farmers left the industry by making quit claims and two left by other means. The Ontario Federation of Agriculture estimated that for every farmer declaring bankruptcy, as many as 10 farmers were under pressure to sell out. Furthermore, it is difficult to determine which impacts are due to high interest rates and difficulties in arranging refinancing as opposed to financial management problems. Any picture of economic distress will also be clouded by the actions of farmers attempting to improve their cash position, reduce risk and protect their business reputation.

Figure 1. REALIZED NET FARM INCOME

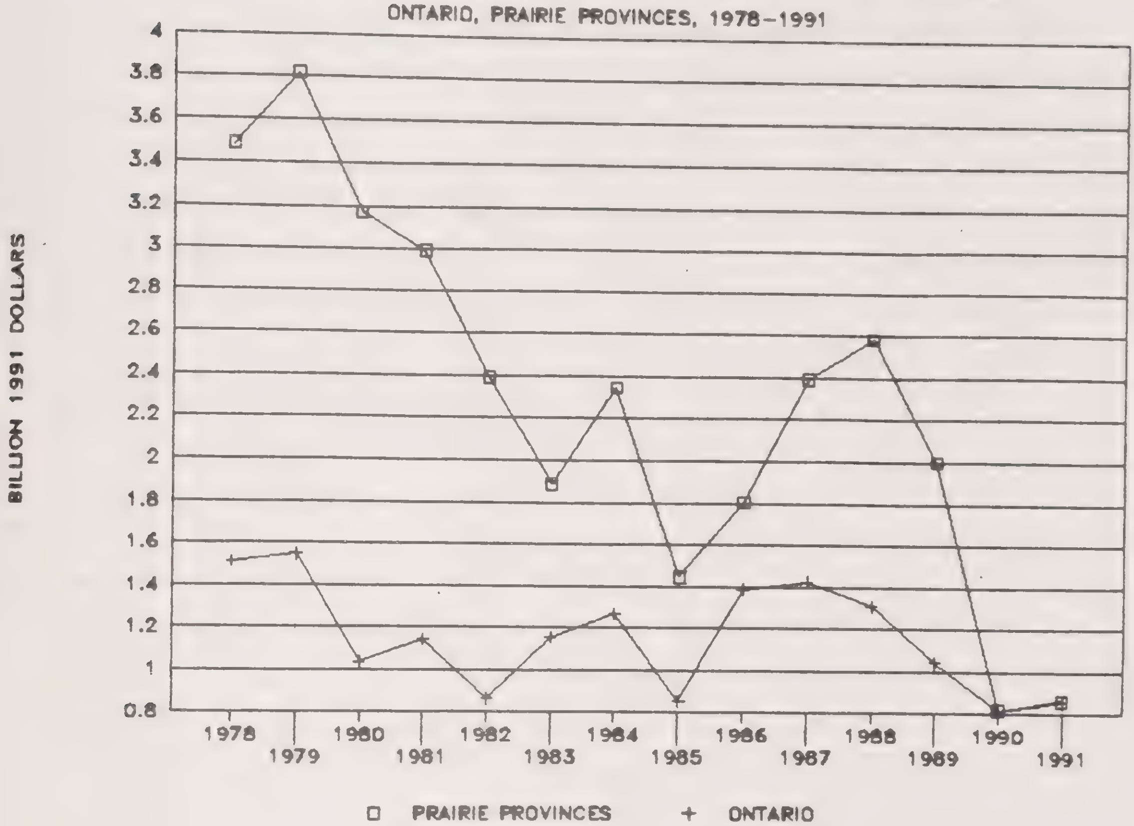

Figure 2. INTEREST COVERAGE RATIO

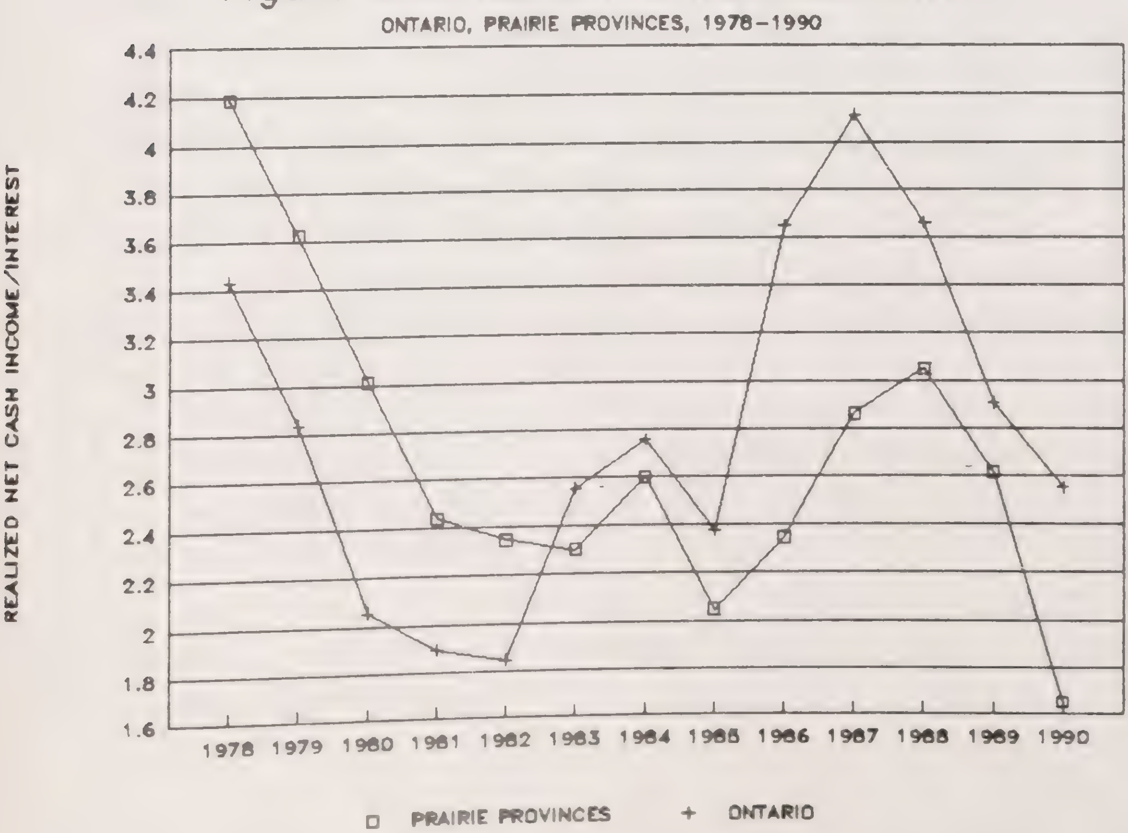

TABLE 2: ANNUAL FARM BANKRUPTCIES, 1979 TO 1990

Type of Farm	Number Filed											
	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[1]	1990[1]
Livestock	53	98	126	188	209	239	201	164	82	57	–	–
Field Crops	17	44	31	83	132	138	126	115	129	154	155	146
Fruit & Vegetable	9	8	10	8	23	18	18	19	9	20	14	17
Livestock & Field Crop Mixed	18	31	36	37	62	82	85	75	76	55	54	102
Miscellaneous Specialty	28	41	58	94	62	74	78	67	58	39	–	–
TOTAL	125	222	261	410	488	551	508	440	354	325	334	407

1 Bankruptcy Branch changed the classification system in September 1989, breaking the statistical comparability of some classes of farms.

Source: Canada, Consumer and Corporate Affairs, Bankruptcy Branch, Ottawa, January 1991.

TABLE 3: NUMBER OF FARM BANKRUPTCIES BY QUARTER, 1989 to 1991

Type of Farm	S.I.C. Code[1]	1989	1990				1991	
		Oct. -Dec.	Jan. -Mar.	Apr. -June	July -Sept.	Oct. -Dec.	Jan. -Mar.	Apr. -June
Livestock	011	22	21	21	21	38	23	33
Field Crops	013 & 014	39	47	37	30	32	43	55
Fruit & Vegetable	015	5	2	3	2	10	5	7
Livestock, Crop & Hort. Combination	017	17	29	26	27	20	38	36
Animal Specialties	012	(	3	4	4	12	8	4
Horticultural Specialties	016	(8	4	5	6	3	9	9
TOTAL AGRICULTURE	01	91	106	96	90	115	126	144

(1) 1980 Standard Industrial Classification which was applied by the Bankruptcy Branch in September 1989.

Source: Canada, Consumer and Corporate Affairs, Bankruptcy Branch, Ottawa, July 1991.

Arrears on loans are an indicator of financial stress. Only 7.0% of all 70,354 *Farm Credit Act* (FCA) loans were in arrears at 31 March 1976. The total arrears of amounts above $100 represented only 6.4% or $9.56 million of the amount owed to the Farm Credit Corporation in the previous 12 months. At the end of the 1984-85 fiscal year, the percentage of FCA accounts in arrears increased from 12.4% in the preceding year to 15.3%. The amounts owed above $500 increased by 49% from $107 million to $160.3 million at 31 March 1985. By 31 March 1988, 18.3% of 71,793 FCA accounts were in arrears totalling $377.6 million. At 31 March 1989, 15.5% of 66,913 FCA active accounts were in arrears totalling $283.9 million. At 31 March 1990, 13.6% of 63,628 FCA accounts were in arrears totalling $192.7 million. By 31 March 1991, 12.1% of 61,281 accounts were in arrears amounting to $132.9 million. **At 30 June 1991, 20.9% or 12,802 accounts of 61,312 active accounts were in arrears amounting to $166.6 million. That compares with 22.0% or 13,927 accounts in arrears among 63,370 active accounts and an amount of $231.4 million on the same date in 1990.** While the financial indicators were improving, the number of farm properties held by the FCC increased from 825 at the end of February 1988 to 2,259 at 31 March 1991. By 30 June 1991, **real properties on hand totalled 2,310 compared to 1,767 one year ago.**

Farm debt outstanding in Canada totalled $22.54 billion at 31 December 1989. In constant dollars, based on the gross domestic product implict price index as a measure of changing purchasing power, that amount was 5.8% below 1988 and 17.1% below the peak level of 1986. **By 31 December 1990, farm debt outstanding reached $23.78 billion.**

The percentage of loans used for debt consolidation is another indicator of difficult financial times. The combined percentage of *Farm Credit Act* loans used to refinance both land-secured debts and other debts increased from 30.6% in 1978-79 to 52.2% in 1982-83. Again in 1983-84, 51.2% of the $778.9 million in all loans was used to repay such debts. By 1988-89, the percentage of newly approved loans used to repay land-secured debt and other debt was 41% compared to 61.1% in the preceding year. At 31 March 1991, 42.1% of the amount loaned was used for refinancing. By 30 June 1991, **the percentage of FCA loan funds used for refinancing increased to 46.5%.**

The ratio of realized net cash income* to interest on indebtedness (interest coverage ratio) is an indicator of the capacity to service debt and of the vulnerability of agriculture to the debt load at current interest rates. Between 1973 and 1975, farmers in Canada had $8.24 to $7.63 of net income for every dollar of interest payments. Thereafter, as interest rates and payments increased relative to stagnating net income, the ratio decreased considerably. The realized net cash income per dollar of interest payments across Canada was $3.33 in 1979, $3.39 in 1988 and $3.02 in 1989. However, in 1990, net income per dollar of interest payments was $2.35 for Canada and lower in the western provinces, being $1.36 in Saskatchewan and $1.65 in Alberta **(see Figure 2)**.

The 1984 Farm Survey by the Farm Credit Corporation indicated that the financial plight of some of Canada's most productive farmers was more serious than previously comprehended. One-third of the farmers surveyed had low equity of around 60% or less and carried nearly 80% of the total farm debt. They were Canada's youngest farm operators and produced about one-half of the nation's food output. These younger farmers were suffering the most financial stress.

The 1988 Farm Survey showed that one-third of the farms surveyed had an average equity of 55%. The equity position of these farms had worsened in the Prairie and Atlantic regions. Low-equity farms in these regions carried 10% to 17% more liabilities per dollar of assets than in 1984, but in Saskatchewan the liabilities per dollar of assets had increased by 38%. These farmers carried about 75% or $16.9 billion of the total farm debt and consequently, the greatest burden of financial stress. They represented Canada's youngest and most productive farmers, who produced about 45% of the nation's agricultural production.

The 1990 FCC Farm Survey showed that one-third of the farms, operated by the youngest and most productive farmers, are carrying 80.7% or $17.92 billion of the total farm debt. Although their total liabilities have increased in all provinces except Alberta and British Columbia, the liabilities per dollar of assets and per dollar of farm revenue have

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* Realized net income less income-in-kind plus interest; represents cash for living and debt repayment from the farm enterprise.

decreased for this group in all provinces. Consequently, their equity position on a national basis has improved to 60%, since the previous survey. However, their equity and share of farm debt is the same as in 1983. The equity of all farmers improved slightly to 82.7%, while total farm debt decreased marginally.

C. How Well Can Farmers Cope With High Interest Rates?

We have dealt with some of the extreme effects of high interest rates. Of course, many farm businesses may in fact be in no danger of bankruptcy or foreclosure but, because of high interest rates or other factors, may be operating at far less than a fair return on investment. Recent studies *(Farm Incomes in Canada,* George L. Brinkman, Economic Council of Canada, 1981) have shown that if capital gains are taken into account, farm operations can be as profitable as businesses of similar size. Despite any immediate benefits derived from capital appreciation, farmers point out that it does not produce cash-flow, which they need for reinvestment and for day-to-day expenses.

Furthermore, liquidating assets to realize capital gains is likely to be difficult in times of general financial duress. The problem is intensified by the decline in land values that occurred in most provinces from 1982 to 1987, and into 1988 in the Prairie Provinces. Consequently, farmers have experienced capital depreciation and restrictions on credit based on the reduced equity in their enterprises.

Another problem for farmers arises from their role as price-takers in a competitive market structure. Even with marketing organizations, farmers have difficulty passing on higher costs immediately to consumers. Higher interest costs are no exception. The problems of adjustment to high interest rates are just as formidable for farmers as for other businessmen.

On the other hand, we must recognize that farm income stability has been enhanced in recent years and that the relative wealth of established commercial farmers cushions the impact of high interest rates. Furthermore, good financial organization and long-term planning are practised on many farms. Although agriculture has become a highly capital-

intensive industry dependent on credit to maintain and improve farm production, farmers in general are not highly leveraged. The equity of Canadian farmers decreased from 85% in 1981 to 80% in 1988. However, the equity of even good farm managers can be eroded in difficult economic periods.

D. Outlook and Long-Term Impacts

During the past several years, short-term and long-term interest rates have been much further above the inflation rate than during the years prior to 1980. **During the first quarter of 1991, the real interest rate based on the chartered banks' prime rate averaged 5.14%. In the second quarter, it decreased to 3.82%.**

The trend to lower nominal interest rates could be limited by the Bank of Canada's ongoing policy of monetary restraint to bring about price stability. The budget paper of 26 February 1991 notes that the reduction of inflation, rather than expansionary monetary policy, is the only way to lower interest rates permanently. It states that "the government and the Bank of Canada are determined to eliminate inflation." Accordingly, the inflation target policy aims to reduce the annual increase of the consumer price index to 3% by the end of 1992 and to 2% by the end of 1995.

At the Bank of Canada Board of Directors' meeting in February 1991, Mr. John Crow, the Governor, emphasized that any reduction in short-term interest rates should be sustainable and consistent with the easing of inflationary pressures. The easing of domestic cost pressures was still not very evident. Consequently, at the meeting of the Board of Directors in March 1991, the Governor noted that the bank's monetary policy operations since mid-February were aimed at resisting speculative pressures that might lead to excessive and unsustainable decreases in short-term interest rates. At the meeting of the International Monetary Fund, in the last week of April 1991, the New Minister of Finance, Mr. Don Mazankowski, indicated to reporters that it was important to maintain the government's current monetary course in order to restrain inflationary pressures and expectations. **In a speech to the Investment Dealers Association of Canada**

on 17 June 1991, Mr. Crow reiterated this policy and noted the continued monitoring of costs and prices.

Economic hardship in the agricultural sector can have far-reaching impacts affecting the welfare of many people other than farmers and their families. We have observed the extension of such problems into the farm machinery industry and other farm supply industries as farmers have been forced to curtail expenditures and new investment. By 1985, manufacturers' shipments of farm machinery decreased 28.7% from the 1981 peak level to $808.6 million, their lowest value since 1974. The average number of hourly-paid employees in this industry also decreased by 48% from the 1981 level, to about 5,400. By 1989, shipments advanced to $1,135. However, in 1990, shipments were only 6.7% less than those of the preceding year. In January 1991, the number of hourly-paid employees was reduced to 5,200 or 26.8% less than a year before.

E. Where Does the Issue Stand Now?

While it is recognized that all farmers in financial difficulty cannot be maintained in business, a laissez-faire decimation of good entrepreneurs in the productive mainstream of agriculture is unacceptable. The consensus is that some farmers should receive short-term assistance to enable them to remain in business until more effective long-term initiatives for farm credit are developed.

The federal Minister of Agriculture suspended all foreclosure actions by the Farm Credit Corporation from 5 November 1984 until 15 January 1985. Since that date, appeal boards reviewed the financial situation of farmers facing an FCC foreclosure and made recommendations to the Corporation. In mid-September 1985, the Minister declared a second moratorium on FCC foreclosures pending government decisions on debt review legislation and a review of the FCC's mandate, the results of which have not been published. One year later, the moratorium remained in effect while Farm Debt Review Boards and the Canadian Rural Transition Program commenced operations. The Minister then announced a controlled phase-out of the moratorium effective 1 May 1987. Farmers facing FCC recovery action may apply to the Debt Review Boards and the Rural Transition Program. At

the 1989 federal-provincial agriculture ministers' conference, the federal Minister of Agriculture stated that the review of the FCC's mandate was not yet completed.

The Federal-Provincial Conference of Ministers and Deputy Ministers of Agriculture, meeting in November 1984, recommended immediate action on extending the Special Farm Financial Assistance Program of the FCC for two years, extending the Small Business Bond Program to 1989, providing fixed interest rate loans for one- to five-year terms under amendments to the *Farm Improvement Loans Act* and improving the uniformity of cash advance programs for all commodities.

The Ministers outlined other proposals for further review. These are to amend the *Farm Syndicates Credit Act* so that two farmers could jointly obtain credit to buy machinery; to encourage commercial lenders to use new credit instruments (long-term fixed-rate loans, accrued interest rate mortgages, shared appreciation mortgages and shared risk mortgages); to examine the development of a protection scheme against interest rate increases on commercial mortgage loans; to provide guarantees for expanded mortgage credit from private individuals under more favourable conditions than commercial sources; to examine the feasibility of a farmer-controlled bank; and to encourage parliamentary progress on agribonds.

At their 1989 conference, federal and provincial agriculture ministers indicated they were not ready to implement a new farm credit policy. The Canadian Federation of Agriculture was expecting some action on its proposals for lower interest rates, financing programs for beginning farmers and a new mandate for the FCC. In their 1990 meetings, the agriculture ministers focused on income support measures for the grains and oil seeds sector, particularly on the safety net programs and the allocation of $450 million of interim federal support.

Farm finance was discussed at the First Ministers' Conference at Halifax in November 1985. The federal and provincial Ministers of Agriculture presented a public report to the First Ministers in November 1986 on a national agricultural strategy outlining the elements of long-term action in farm financing, market risk and other areas. The principal activity has been income support through the Special Canadian

Grains Program, which paid grain growers $1 billion in 1986-87 and $1.1 billion in 1987-88, to offset the reduction in grain prices caused by the subsidy war between the United States and the European Economic Community. Statistics Canada estimates that, in 1989, Canadian farmers received net direct payments totalling $2,973 million from federal and provincial income support programs, which represented 13.2% of total cash receipts.

The Premiers noted, at their annual conference in August 1988, that Canadian interest rates have recently been at high levels relative to inflation and to U.S. interest rates. They discussed the impacts of higher rates on the costs of resource sector enterprises, small businesses and farmers, and on business investment and job creation. Their concern to keep interest rates as low as possible was conveyed to the federal government. The prime rate rose 4.0% after the 1988 meeting, and the spread between Canadian and American prime rates reached 4.75%. At the 1989 and 1990 conferences, the Premiers repeated their complaint about high interest rates.

The implementation of the *Farm Income Protection Act,* particularly GRIP and NISA, was the major topic at the July 1991 meeting of agriculture ministers. The federal minister of agriculture, Mr. Bill McKnight, stressed the shared responsibility for program funding, consistency in the federal-provincial agreements on GRIP and NISA, and cooperation on the analysis for an early GRIP payment. With regard to special assistance measures (third line of defence under section 11 of the Act), that are outside the scope of the current GRIP/NISA agreements, the federal government has agreed to provide funding this year and the provinces will undertake measures for adjustments in agriculture.

From 1 April 1985, the FCC offers shared risk mortgages to farmers qualifying for a loan from the Corporation. Annual change in the interest rate of the mortgage is shared equally between the borrower and the Corporation. This new mortgage will protect borrowers against large increases in interest rates because there is a ceiling of 2.5% on interest rate increases over the six-year term of the mortgage. The loan limit is $350,000 for one applicant and $600,000 for more than one. This type of mortgage represents about 50% of FCA loans approved.

The Farm Credit Corporation has experienced difficulty in reconciling its role as the lender of last resort to higher-risk clients with the requirement that it cover its costs. In fiscal year 1987-88, the corporation had a loss on operations of $511.84 million and a deficit of $854.96 million attributed mainly to a higher allowance for loan losses and to lower interest income from loans. On 11 December 1987, a new Chairman, James Hewitt, was appointed to restore the financial viability of the FCC. A new Vice-Chairman, Gerald Penney, was also appointed. On 15 December 1987, the federal government announced the following interim financing for the corporation: deferral of a loan payment of $103 million due in January 1988; provision of $100 million for corporate losses; provision of $30 million to enable the FCC to participate in financial arrangements made through the Farm Debt Review Boards in 1987-88 and up to $300 million for that purpose during the next three years. The Corporation's 1989-90 annual report shows that its financial position is recovering through fewer loans in arrears and reduction in the total amount of arrears, a considerable reduction in its operating loss, greatly improved equity, and increased lending volume. The latest five-year plan states that further financial restructuring of the FCC will be necessary to restore financial viability.

Provincial government support ranges from credit guarantees for qualifying farmers and interest rate subsidies to restrictions (under The *Farm Land Security Act)* on foreclosures on farm land in Saskatchewan. On 30 July 1986, the Government of Ontario introduced a three-year program of $150 million to reduce interest costs to an effective rate of 8% for heavily-indebted farmers having 10% to 75% equity and a reasonable chance of survival. In 1987, Alberta commenced a $2 billion farm loan program through commercial lenders, with a fixed interest rate of 9% for up to 20 years, for the purpose of restructuring existing debts not exceeding $200,000 per farm family. On 9 February 1987, Manitoba proclaimed the *Family Farm Protection Act* to provide mediation in foreclosure actions and to facilitate court settlements. The Government of Ontario implemented a one-year interest payment reduction program of $50 million for 1991, which will give some 7,000 individual farmers grants of up to $8,000. The

program's formula targets the assistance to farms with moderate income and burdensome interest costs.

The Ontario Cattlemen's Association, with help from the Ontario Ministry of Agriculture and Food, set up a financial co-operative in Lambton County in 1990 to enable members to obtain financing at lower rates. The Ministry guarantees 25% of the debt, if the organization's trust fund is depleted. During the past six years, 63 farm financial co-operatives have been established in Saskatchewan.

On 20 July 1990, the first report of the Farm Finance and Management Task Force was released. It made five recommendations: (1) develop a national farm finance policy on the cost and availability of credit; (2) establish a clearly defined role for the FCC (and at least continuation of its current role); (3) extend the mandate of the Farm Debt Review Boards; (4) establish a national program for farm management training, services and information; (5) establish a federal-provincial-industry process to facilitate early action on the recommendations.

In June 1991, the Farm Finance and Management Task Force delivered its final report. The specific recommendations of the report included the following: 20-year fixed interest rate loans to farmers at market rates, that are renegotiable if interest rates decrease; a beginning farmer program with financial assistance up to five years and guaranteed private mortgages; a new lease-to-own program for farmland to be implemented through amendments to the *Farm Credit Act;* the establishment of a national program for farm business management training, services and information; and a training/employment assistance initiative for farm families similar to a program available under the Canadian Jobs Strategy.

PARLIAMENTARY ACTION

Interest rate policy in relation to agriculture has been heavily debated in the House of Commons since October of 1981. Members pointed out that both the Government and financial institutions had a responsibility to investigate the advisability of aid to farmers faced with high interest rates and high input costs. On several occasions, Members

asked that action be taken to permit the Farm Credit Corporation to lend more money at reasonable rates and that additional sources of funds be made available to the Corporation. Various noteworthy actions are listed in the chronology.

In the 26 February 1986 budget, the Farm Credit Corporation was authorized to implement a $700 million commodity-based mortgage program for two years beginning 1 April 1986. The program was intended to provide cash flow relief in the short term to about 5,000 farmers by refinancing existing debts of viable FCC clients having 20% to 55% equity. Income volatility was taken into account by indexing the outstanding principal of the new mortgage to the variable prices of commodities chosen by the farmer. Interest was paid at 6% for 10 years on payments amortized for 20 years. Although the program had been previously extended to 31 March 1991, the Budget of 27 April 1989 terminated it in order to reduce federal expenditures by $14.5 million over the next two fiscal years. The Department of Agriculture will continue to reimburse FCC in 1991-92 for interest rate concessions in this program.

On 26 June 1986, the *Farm Debt Review Act* (C-117) was passed by the House of Commons to establish in each province, a Farm Debt Review Board and Panels with authority only to review the financial affairs of an applicant and to facilitate voluntary arrangements between a farmer and his creditors during a stay of proceedings. The Boards are established and functioning in all provinces. **By 30 June 1991, since the beginning of the program, 16,248 applications had been received throughout Canada, including 5,282 from insolvent farmers. In the same period, 12,444 applications were completed, of which 8,354 had arrangements signed with their creditors. Program funding is extended to 31 March 1992.**

The Canadian Rural Transition Program commenced on 10 September 1986. This program introduced in the February budget provides financial assistance, job counselling, training, relocation assistance and self-employment grants or wage subsidies for farmers leaving farming after 26 February 1986. It is intended to facilitate the transition to new employment for families leaving farming because of financial difficulties. **By 30 June 1991, 4,710 applications had been received, of which 3,787 were**

approved and 106 were pending. Program funding is extended to 31 March 1992.

In the Report on Farm Input Costs tabled in the House of Commons on 29 June 1987, the Standing Committee on Agriculture recommended that the government instruct the FCC urgently to develop its equity financing proposal. The Committee recommended also that the FCC be allowed to hold land for longer than five years and to provide long-term leases with an option for renewal or buy-back of the land. The government is examining the potential benefits of long-term leases but it has stated that it is not at present in a position to make a decision on equity financing. It encouraged the Standing Committee on Agriculture to examine thoroughly the merits and difficulties of equity financing for agriculture, as well as its cost effectiveness and private sector involvement.

In April 1988, the Standing Senate Committee on Agriculture and Forestry published the report of its study, entitled *Financing the Family Farm to the Year 2000.* That Committee made recommendations to maintain and improve the mediation role of the Farm Debt Review Board, to maintain the Farm Credit Corporation as a direct lender, to provide farm management information systems, and to create a secondary agricultural mortgage market. At 20 December 1989, the Committee updated its report and reaffirmed its previous recommendation concerning the Farm Credit Corporation's mandate. It recommended the examination and renewal of the Farm Debt Review Board Program and the Canadian Rural Transition Program. The Committee recommended also the establishment of a disaster relief fund to assist with income shortfalls.

On 28 July 1988, the Standing Committee on Agriculture tabled its report entitled *The $22 Billion Dollar Problem: Options for the Financial Restructuring of Farm Debt.* The Committee recommended that the FCC have both a commercial and policy role in agricultural lending, and receive compensation for the latter. It recommended that FCC ownership of farm property be extended beyond five years to allow participation in long-term leases and lease-purchase arrangements. The government is advised to give a positive signal of support for private sector development of equity financing. Innovative programs for shared-appreciation

mortgages, variable rate mortgages and an interest stabilization plan are recommended. The Committee's recommendations on the Federal Debt Review Boards included the use of more uniform and equitable guidelines on farm viability and debt restructuring, and the provision of a report to the farmer outlining the Board's recommendations where no agreement is reached with the creditors.

On 9 May 1991, the Standing Committee on Agriculture tabled a report entitled "Farm Debt Update - 1991." The report, based on the FCC 1990 farm survey, notes that the total farm debt outstanding of $22.2 billion at 1 January 1990 is only slightly lower than the 1987 peak level and that average debt per farm has increased in all provinces except British Columbia, Saskatchewan and Manitoba. Excess debt remains almost unchanged since 1987 at $4.88 billion, with about 78% of the national farm debt being serviceable. Some 19% of farmers in Canada are hardly able to service their debt and another 10.6% have severe debt service problems. The possible direction of farm debt and the percentage of farmers in various risk categories are examined under five different projections of financial conditions in 1992. Recommendations are not published in this report.

CHRONOLOGY

18 July 1959 - The *Farm Credit Act,* an Act to provide for the extension of long-term mortgage credit to farmers, received Royal Assent, establishing the Farm Credit Corporation. The Act enables the Corporation to loan up to 25 times its capital.

September 1975 - The Bank of Canada focused on combating inflation through lower monetary growth. In November, the Governor of the Bank of Canada announced targets for M1 growth (M1 being currency in circulation plus demand deposits in chartered banks).

10 March 1980 - To adapt to short-term interest volatility, the Bank of Canada adopted a floating Bank Rate to be set weekly at 0.25% above the average percentage yield of 91-day Treasury Bills at Thursday auctions.

December 1980 - The United States and Canadian prime rates reached 21.5% and 18.25% respectively.

1 April 1981 - Despite calls by farm lobby groups for moderation, the FCC raised rates to 14% following its policy to reflect the previous six-month average of rates of return on long-term government bonds.

26 August 1981 - Canadian Bank Rate was set at the unprecedented high of 21.03%. Commercial loan rate for the chartered banks' best customers was 22.75%.

October 1981 - Farm Credit Corporation raised its rate to 16.75%.

12 November 1981 - The federal budget provided $50 million for loans, through FCC, at 11.75% to farmers in difficulty with higher current interest rates. Small Business Development Bonds were extended to farmers.

30 March 1982 - Bill C-88, An Act Respecting Loans to Farmers, was passed by the House of Commons. It provided interest rebates and raised loan limits to farmers. The FCC's capital was raised to $225 million and the Corporation was permitted to obtain funds in capital markets.

28 June 1982 - In its new budget the federal government provided $100 million more for the Special Farm Financial Assistance Program to farmers in financial difficulty, allowing an expansion of loans by the FCC and an extended interest rebate program.

29 November 1982 - Bank of Canada abandoned monetary targeting of MI.

16 December 1982 - Royal Assent given to Bill C-134, *Farm Loans Interest Rebate Act (No. 2).*

16 March 1983 - Second reading and referral to Committee of Bill C-653, An Act to Amend the Farmers' Creditors Arrangement Act. It was terminated at the adjournment of the session.

22 August 1983 - Semi-annual adjustment of FCC interest rates was abandoned. Periodic adjustments based on Crown corporations' rate and the cost of FCC borrowing will be made by Orders in Council.

9 May 1984 - Bill C-17, An Act Respecting Bankruptcy and Insolvency, was given second reading and referred to the Standing Committee on Finance, Trade and

Economic Affairs. It was terminated by the dissolution of the 32nd Parliament.

March 1985 - The Standing Committee on Finance, Trade and Economic Affairs reviewed the discussion paper entitled *Tax Issues in Agriculture* and made recommendations concerning the write down of certain loans by the FCC, and the design and implementation of an agribond program.

1 April 1985 - The Farm Credit Corporation introduced shared-risk mortgages.

23 May 1985 - The federal budget introduced a lifetime exemption of $500,000 for capital gains on the sale of farm property and extended farmers' access to the Small Business Bond Program.

28 June 1985 - The *Farm Improvement Loans Act* was extended from 1 July 1985 to 30 December 1986.

10 July 1985 - Federal Minister of Agriculture, the Honourable John Wise, announced an in-depth review by the Farm Credit Corporation of its mandate and role, to be reported by the end of September. The results of the review have not yet been made public.

1 April 1986 - The Farm Credit Corporation introduced commodity-based mortgages at 6% interest.

26 June 1986 - Bill C-117, the *Farm Debt Review Act,* was passed by the House of Commons.

10 September 1986 - The Canadian Rural Transition Program commenced.

18 December 1986 - Bill C-31 was passed to extend the *Farm Improvement Loans Act* to 30 June 1987.

1 May 1987 - The moratorium on FCC foreclosures began to be phased out.

30 June 1987 - Bill C-78, the *Farm Improvement and Marketing Cooperatives Loans Act* was passed by the House of Commons to raise the borrowing limit to $250,000 at a prescribed interest rate and to broaden the application of the Act.

11 & 14 December 1987 - New Chairman and Vice-Chairman were appointed to the FCC.

15 December 1987 - The federal government provided interim financing to alleviate financial problems of the FCC.

31 March 1989 - In the Budget of 27 April, the commodity-based loan program was terminated.

20 July 1990 - The first report of the Farm Finance and Management Task Force was released, with important recommendations on FCC and Farm Debt Review Boards.

26 February 1991 - The government and the Bank of Canada jointly announced an inflation target policy to reduce inflation expectations and to promote lower interest rates.

11 April 1991 - The *Farm Income Protections Act* (Bill C-98) received Royal Assent after being passed by the House of Commons on 27 March 1991.

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